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No. 84-393 (2)

IN THE

Supreme Court of the United States

October Term, 1984

WACHOVIA BANK AND TRUST COMPANY, N.A.,
Petitioner,

-vs.-

WILLIAM K. BANISTER,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Dated: October 29, 1984

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Respondent, William K. Banister, respectfully prays that this Court deny the petition for a writ of certiorari to review the June 13, 1984 judgment of the United States Court of Appeals for the Second Circuit.

STATEMENT OF THE CASE

Respondent Banister was the president and sole stockholder of Northern Yachts, a corporation that had been a principal dealer since 1964 for custom yachts built by Hatteras Yachts. In 1971 Hatteras, in order to promote its new and expanded line of boats, proposed that Northern Yachts enter into a floor-plan financing arrangement with Wachovia which would enable Northern Yachts to acquire new inventory boats by paying 10% cash, with the bank financing the remaining 90%. That arrangement provided for a single constant floor plan agreement to cover all transactions and for an individual note/security agreement to be executed at the time of each transaction. The relevant parts of the floor plan agreement provided:

> "2. FINANCING TRANSACTIONS: We hereby agree as follows: (a) to notify you, prior to our receipt of any Inventory which we desire to be financed hereunder, of the facts with respect thereto and the amount and nature of the Advance desired; . . . (c) each Advance made by you shall constitute a new Advance by you to or for our account or benefit as of the time of such Advance; (d) any such Advance may, if you then elect, be paid to us, but *in every such case we agree that such Advance or the proceeds thereof will be used only in paying the purchase price of the Inventory being financed thereby, and for no other purpose;** (e) to repay to you the amount of each Advance with interest at the rate agreed in accordance with a promissory note therefor, which promissory note we agree to execute and deliver to you, concurrently with the Advance, in such form and with such terms as you may prescribe; (f) promptly upon or prior to the delivery to us of the Inventory financed by such Advance, *to execute and deliver*

*to you a trust receipt or receipts, or other security instrument, covering the Inventory financed by such Advance, in form and with terms prescribed by you;** (g) to pay promptly to you such amount of the cost of the Inventory as you may from time to time require; . . . (j) you shall have the right to collect all refunds payable to us by the manufacturer and/or distributor of any Inventory financed hereunder, and you shall apply the same in reduction of our obligations to you; and (k) *notwithstanding anything to the contrary contained in any trust receipt, promissory note or other instrument given by us to you hereunder, in the event any Inventory is sold, we will remit to you, the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale of each such item.** Any security in Inventory given to you will secure the payment of all obligations owed by us now or hereafter." (*Emphasis added).

Each note/security agreement provided:

"_____days after date the undersigned promises to pay to Wachovia Bank and Trust Company, NA (hereinafter called Wachovia), or order, the sum of _____ Dollars for value received with interest . . .*if default is made in the payment of any amount due hereunder this note shall immediately become due and payable in full at the option of the holder hereof.**

* * * * *

"If the property described herein is held by the undersigned as 'Inventory,' the undersigned agrees to care for and hold such property only for the purpose of sale at retail and agrees further: . . .*(2) that in the event of the sale of any item of property or other disposition*

*thereof, the undersigned will pay promptly to Wachovia the amount due upon each item described.** (3) that the undersigned will keep any and all property, in whatever form same may be at any time or times, separate and capable of identification as the property of Wachovia and will surrender and account therefore to Wachovia forthwith upon demand and (4) that all provisions of any underlying FLOOR PLAN AGREEMENT between the undersigned and Wachovia, not inconsistent with anything contained herein, shall be considered as a part of this document as if fully set out herein . . . " (*Emphasis added).

Wachovia contends that the language of these agreements required Northern Yachts to hold whatever proceeds were received upon the sale of an inventory boat "in trust" for Wachovia[1] and to promptly remit such proceeds to Wachovia[2] Banister, while recognizing that the funds furnished by Wachovia must be used solely for the purpose of purchasing the inventory boat described in the security agreement and as such may be deemed to be trust funds, contends that there was no equivalent trust requirement with respect to the proceeds, and that instead the note/security agreements simply provide that Northern Yachts "will promptly repay to Wachovia the amount due upon each item described;" or put another way, the documents fix two maturity dates for the floor-plan loan; (1) a stated term after execution of the note/security agreement, or (2) upon sale of the item, whichever first occurs. The decision below concurs with respondent Banister's contention.

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[1] Petition page 5.

[2] Petition page 8.

The nature of the business and the course of dealings between the parties tend to establish that neither the parties nor the floor plan documents contemplated that the proceeds from the sale of inventory boats would be remitted "in kind" to either Hatteras or Wachovia. Firstly: the yachts involved take many months to build and outfit, and thus a dealer must anticipate his needs and place his orders months (even more than a year) ahead of delivery. After the order has been placed, the dealers frequently contract to sell that boat and actually take in a trade long before the inventory boat is ready for delivery; in fact the trade-in may be disposed of before the delivery date.[3] Secondly: in such transactions the dealer is often unable to pay off the note when the boat is sold because he still has the trade-in on hand, and he thereby becomes in arrears. Although both Hatteras and Wachovia were cognizant of such custom and practice, neither of them required the dealers to give any further security with respect to the trade, and neither they or the documents required the dealers to maintain a trust account or to segregate any of the proceeds received from the floor-planned boats. During the ten years of its dealings with Hatteras, Northern Yachts maintained but a single business account for all deposits and expenditures, and not once did either Wachovia or Hatteras inquire as to the manner in which Northern Yachts handled its monies.

There was no evidence that either Northern Yachts, or its president Banister, secreted any boats from or that either concealed or misrepresented any facts concerning the sale of the boats in question to Wachovia or Hatteras. Likewise there was no proof that Banister personally profited or benefited in any way from the proceeds of such boats.

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[3] Both of the inventory boats involved in the instant case had been sold prior to their delivery date: Hatteras knew nine months before the delivery of the 58 foot yacht that it had been sold to Mr. Gutchess and that his trade in had been sold; and Hatteras likewise knew the 53 foot yacht was sold to Mr. Rothenhaus. Hatteras in fact delivered each of these boats directly to the customer, and thus knew that neither boat was ever in the custody of Northern Yachts.

SUMMARY OF ARGUMENT

This action was brought under the provisions of sections 17(a)(2) and (4) of the Bankruptcy Act of 1898, as amended, 11 U.S.C. §35 (1979), now replaced by section 523 of the Bankruptcy Code, 11 U.S.C. §523 (1982). The principal issue is whether a principal corporate officer who fails to disburse to a secured creditor proceeds from the sale of inventory in which the creditor has a secured interest incurs a debt that is non-dischargeable in the personal bankruptcy of that officer.

The determination of that issue involves interpretation of the financing transaction documents executed between petitioner bank ("Wachovia") and respondent Banister's corporation, Northern Yachts, Inc., for the floor-planning of large custom built yachts intended for retail sale. The decision below was in accordance with well established rules: that under section 17(a)(2) there can be no conversion where the financing documents failed to give Wachovia ownership or an immediate right of possession to the proceeds from the sale; and that under section 17(a)(4), unless such documents create an express obligation to hold in trust such proceeds, a corporate officer is entitled to a personal discharge where he has not personally benefited from the use of the monies.

There is no question of law involved that justifies the grant of a writ of certiorari.

ARGUMENT

Contrary to the statements in the petition that the language of the floor-plan documents

> "obligated Northern (Yachts) to hold whatever proceeds were received upon the sale of the Hatteras yacht, including cash, the trade in boat and its proceeds, *'in trust'* for Wachovia" [4]

and that the Floor Plan Agreement and Note and Security Agreement also

> "require the debtor (Northern Yachts) to promptly remit the proceeds of sale of a floor planned boat."[5]

those documents, even when read together, contain no such language or provisions.

It is axiomatic that any ambiguity arising from the language of the documents prepared and furnished by Wachovia must be resolved in favor of Northern Yachts and Banister. See:

> *4 Williston on Contracts*, § 621, p. 760 *et seq.* (New Third Edition);
>
> *Hurd v. Illinois Bell Tel. Co.*, 136 F.Supp. 125, 134, (ND Ill. 1955) aff'd 234 F2d 942 (CA7 1956), cert. den. 352 U.S. 977 1 L.Ed. 2d 329, 77 S.Ct. 352 (Case 1, 1957);
>
> *Mutual Life Ins. Co. v. Hurni Packing Co.*, 263 U.S. 167, 174 68 LEd 235, 44 S.Ct. 90 (1923).

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[4] Petition at page 5.

[5] Petition at page 8.

Likewise, the interpretation given by the parties themselves, either expressly or by implication from their course of dealing, will prevail. See:

> *4 Williston on Contracts*, § 623, p. 789 *et seq.* (New Third Edition);

Especially, the interpretation by the parties themselves after execution of the documents and before the controversy arose.

> *Pacific Portland Cement Co. v. Food Machine & Chemical Corp.*, 178 F.2d 541, 554 (CCA 9, 1950).

See also, *Insurance Company v. Dutcher*, 95 U.S. 269 (1877) stating at page 273:

> "There is no surer way to find out what the parties meant, than to see what they have done."

All of these considerations were briefed for and presented to the Second Circuit Court of Appeals. Nevertheless, the court reversed the decisions of the lower courts and held that the debt allegedly arising from diversion of proceeds of inventory sold pursuant to the floor plan agreement was dischargeable. The court below noted that Wachovia in drafting the forms of agreement could have, had it chosen to do so, selected "language that unmistakenly creates (in Northern Yachts) an obligation to hold proceeds separate and to remit *'specific money.'*" The court did not speculate on the reason Wachovia failed to do so.[4]

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[4] Appendix to petition at page A6.

THE COURT OF APPEALS CORRECTLY RULED THAT THERE WAS NO CONVERSION UNDER § 17(a)(2)

Although the financing documents provide that they are governed by the laws of North Carolina, the law of New York must be applied in determining whether Banister's conduct there constituted a state law tort.

> *O'Rourke v. Eastern Air Lines, Inc.*, 730 F.2d 842, 846-51 (2d Cir. 1984).

Wachovia on its claim of non-dischargeability under § 17(a)(2) must establish that the failure by Northern Yachts to pay for the two boats promptly upon their sale constituted a conversion. To do so, Wachovia was required to establish two things: (1) legal ownership and immediate right of possession to a specific identifiable thing (i.e., specific money), and (2) that Banister exercised unauthorized dominion over the thing in question.

> *AMF Inc. v. Algo Distributors, Ltd.*, 48 A.D.2d 352, 369 N.Y.S.2d 460 (2d Dept. 1975).

In *AMF, Inc.* the defendant was a distributor of products purchased from plaintiff under a security agreement which by its terms required it to account to plaintiff for *the proceeds* of any goods upon request. In finding that defendant's failure to do so constituted a conversion, the court distinguished *Independent Discount Corp v. Bressner*, 47 A.D.2d 765, 365 N.Y.S.2d 44 (2nd Dept. 1975), a case it had but recently decided, stating that "the crucial issue here is whether the plaintiff had an immediate right to possession of specific monies." By way of contrast the security agreement in *Independent Discount* provided that the debtor upon the sale was "to pay immediately all amounts due (plaintiff) with respect to the products financed" and the court found that there could be

no conversion because there was no specific fund from which the money owed to the creditor was to be paid.

The Second Circuit Court of Appeals found the instant case to be analogous to *Independent Discount* because there is no provision for holding the proceeds for Wachovia set forth in the documents; and that Northern Yachts' (and Banister's) obligation was merely to pay the balance owed upon the sale of the floor planned boats. The Court observed:[7]

> "The floor plan agreement obligated Northern Yachts to remit 'the Unpaid Balance of the Cost Price of each item of Inventory promptly upon the sale of each such item.' Similarly, the note and security agreement required Northern Yachts, in the event of sale, to 'pay promptly to Wachovia the amount due upon each item described.' This obligation to pay 'the balance' or 'the amount due' stands in marked contrast to the language of the acceleration clause, which gave Wachovia the right to declare immediately due all amounts owing if Northern Yachts 'fails to remit promptly any amounts received from any disposition of the property.' The bank's security agreement gave it a right of acceleration in the event that 'any amounts received' were not remitted, but imposed upon its debtor only an obligation to pay 'the amount'. The distinction is assuredly a technical one, but a bank, drafting a form agreement that it hopes will create the basis for claiming, in the event of nonpayment, the existence of a non-dischargeable debt, must select language that unmistakeably creates an obligation to hold proceeds separate and to remit *'specific money.'* "

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[7] Appendix to petition at pp. A6 and A8.

Had the court below found a conversion, it would then have been incumbent upon it to further find that such conversion was willful and malicious on the part of Banister. See Mr. Justice Cardozo's decision in the leading case, *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151 (1934) in which he stated:

> "But a willful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstance. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice."

Mr. Justice Cardozo went on to hold that *"the discharge will prevail as against a showing of conversion without aggravated features."* There is here no evidence of any aggravating circumstances; and as hereinafter discussed, petitioner failed to offer any evidence upon trial that Banister had personally profited or benfitted in any manner from the use of the proceeds by his corporation.

Petitioner's Authorities Distinguished

Although the cases cited in the petition for the proposition that a conversion is committed "where one party exercises unauthorized assumption of the right of ownership or possession to the exclusion of a party who has a superior right to ownership or possession of the property in question"[1] are not in conflict with the decision below, none of them are in point. In fact two of the cases cite with approval *AMF Inc. v. Algo Distributors, Inc.* and *Independent Discount Corp. v. Bressner, supra.* See:

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[1] Petition at page 12.

Meese v. Miller, 79 A.D.2d 237, 242, 436 N.Y.S.2d 496, (4th Dept. 1981) and

First National Bank of Highland v. Merchant's Mutual Insurance Co., 89 Misc. 2d 771, 774, 392 N.Y.S.2d 896 (S.Ct. Ulster Co. 1977).

In *Meese* plaintiff ordered computer equipment and paid the supplier by a check which was deposited in defendant bank. The bank used the monies to pay off a commercial loan of the supplier, and when the plaintiff complained the bank falsely and fraudulently advised plaintiff that his equipment was on order. It was held that the complaint stated a cause of action for intentional fraud against the bank. In *First National Bank of Highland,* the defendant insurance carrier was held liable in conversion for its failure to pay to plaintiff bank collision insurance proceeds where it had constructive notice of the bank's lien on the insured auto. In *Employer's Fire Insurance Co. v. Cotten,* 245 N.Y. 102, 104 (1927) where the plaintiff sued an innocent purchaser of stolen property, who continued to hold it after learning of the theft, the court held that under the circumstances a demand was an unnecessary condition precedent to suit by plaintiff for conversion. In *Bunge Corp. v. Manufacturer's Hanover,* 37 A.D.2d 409, 414 325 N.Y.S.2d 983 (1st Dept. 1971) plaintiff exporter sold oils to a refiner requiring that payment for its warehouse receipts be made by cashier's check. The refiner (who later filed bankruptcy) obtained the warehouse receipts by exhibiting cashiers' checks for which he later presented substituted ordinary checks in payment to the exporter's cashier, subsequently returning the cashiers' checks for a refund. The court held that plaintiff failed to establish that defendant's check switching was unauthorized and that in the exercise of proper supervision should have discovered and put a stop to the scheme. In *Gandy v. Collins,* 214 N.Y. 293 (1915) Judge Cardoza held in an action for conversion that the mortgagee after default had a legal right to possession of the electric trains which had been pledged for a

loan. In *McIndoe v. Ithaca Loan Finance, Inc.* 24 A.D.2d 802, 263 N.Y.S.2d 849 (3rd Dept. 1965) the defendant, acting under a chattel mortgage properly filed more than four months before bankruptcy, replevied the mortgaged property after the bankruptcy proceeding was filed. It was held that the sheriff had acted properly because the mortgage was binding on the trustee, who thereafter had no claim to the property.

THE COURT OF APPEALS CORRECTLY RULED THAT THERE WAS NO MISAPPROPRIATION OF TRUST FUNDS WITHIN THE MEANING OF §17(a)(4)

Neither the documents or the testimony establish that either Northern Yachts or Banister were obligated to remit to Wachovia *the proceeds* or to hold the same in trust for Wachovia.[9] Lacking an *express* or *technical trust*, an implied trust must be distinguished.

> *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S.Ct. 151, 152 (1934)
>
> In *Davis* the debtor was a dealer in automobiles, who sold a car without the prior consent of the lender, although the terms of his loan required him to (1) obtain the prior written consent of the lender to the sale, and (2) "to make prompt remittance of a check." In construing the provisions of §17(a)(4) Mr. Justice Cardozo stated at page 154:

[9] See decision below, Appendix to petition at p. A9.

> "It is not enough that, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee *ex maleficio.* He must have been a trustee before the wrong and without reference thereto. In the words of Blatchford, J.: 'The language would seen to apply only to a debt created by a person who was already a fiduciary when the debt was created.' "

The case held that there had been no misappropriation within the meaning of §17(a)(4).

The Case of *Matter of Whitlock,* 449 F. Supp.1383 (W.D. Mo. 1978) clearly demonstrates the distinction set forth in *Davis, supra.* In *Whitlock* the bankrupt was an officer and director of two subsidiary corporations as well as of the parent corporation which controlled both. One subsidiary financed the sale of mobile homes, while the other acted as the insurance agent for the sale of insurance on the same mobile homes. There was before the Court two sets of claims, the first for failure to pay mobile home dealers for the notes and security agreements which had been sold to banks; the second, a claim by an insurance company for failure to pay the premiums collected for it. The District Court held that Whitlock's indebtedness to the mobile home dealers, because of any personal participation by Whitlock in the defalcation, arose out a breach of an implied, as opposed to an express, trust; and that, in the absence of any personal gain by Whitlock, such indebtedness was dischargeable under §17(a)(4).

The fact that a corporate officer may be liable for corporate debts is not disputed, but such liability does not *ipso facto* exclude such liability from discharge under either subdivisions (2) or (4) of section 17(a) of the Bankruptcy Act. It is almost redundant to here repeat that the record is barren of any evidence that Banister profited or received any personal gain from the transactions. Accordingly, since the proceeds were not subject to an express trust, Banister's liability to Wachovia is a dischargeable debt.

Petitioner's Authorities Distinguished

The cases relied upon in the petition[10] to support the proposition that a corporate officer may not be personally discharged for a debt that arises from his misappropriation of proceeds from sales of collateral for which the corporation was liable are not in point. In each of the three cases, *John P. McGuire Co. v. Herzog,* 421 F.2d 419 (5th Cir. 1970) (floor planned furniture); *Matter of Penning,* 22 B.R.616 (E.D. Mich. 1982) (floor planned snowmobiles); and *Matter of Newman,* 2 BCD 894 (S.D.N.Y. 1976) (floor planned automobiles), the decisions indicate that the bankrupt corporate officer had sustained a personal gain or benefit from his misappropriations.

Likewise, in the cases cited as holding that the courts have not required the secured party to establish that the funds were misappropriated for the debtors personal use, as long as there is a showing of misappropriations, are not in point. *Matter of Folland* 10 B.R. 875 (D. Md. 1981) held that the vice president of a travel agency who participated in the travel agency's misuse of ticket funds, which by the agency agreement were required to be deposited in a specific account, would be held personally liable and nondischargeable regardless whether he had profited personally. Likewise, it was held in *Matter of Newman,* 2 BCD 285 (S.D.N.Y. 1976) that the president of an automobile dealership, which was obligated by its financial agreement to pay over the proceeds from each sale of an automobile, would be held liable for a nondischargeable debt arising from the sale of six automobiles, out of trust, regardless of whether he received any personal gain. In both of those cases the court found an express trust relationship.

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[10] Petition at page 13.

In *Kaufman v. Lederfine*, 49 F.Supp. 144 (S.D.N.Y. 1943) the trustee of a bankrupt corporation brought an action under the provisions of the N.Y. Stock Corporation Law §15 (now Bus. Corp. Law §510) containing an express limitation prohibiting the payment of dividends when a corporation is or would thereby become equitably insolvent. The District Court held that a judgment against an officer of the corporation, who had participated in the improper payment of such dividends, was nondischargeable under §17(a)(4), regardless of the fact that he had not personally benefited. The case is unique, involving as it does a direct violation by an officer of the duties imposed upon him as a corporate officer by the statutes of the State of New York, and is clearly distinguishable.

CONCLUSION

It is respectfully submitted that petitioner has wholly failed to sustain its burden of establishing under Rule 19 that there are special and important reasons why the writ should be granted. The issues here presented involve the interpretation of financing documents prepared by the petitioner, and as such not only are the documents but also the circumstances unique to the instant case. The decision rendered by the court below is in accord with the well established body of law relating to the dischargeability of debts under the former Bankruptcy Act of 1898, sections 17 (a)(2) and (4); therefore it creates no precedent an is unlikely to effect any substantial portion of the various multitude of the financial arrangements now existing.

The decision below did not involve an important question of federal law which has not been, but should be, settled by this court; nor has the Court of Appeals decided a federal question in a way to conflict with applicable decisions of this court or of another Court of Appeals on the same matter. The Court of Appeals correctly reversed the decision of the bankruptcy Judge and the District Court on the law and on the facts.

Dated: Watertown, New York
October 29, 1984

Respectfully submitted,

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